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Exemption Won In '97 Set Stage For Enron Woes

By STEPHEN LABATON

WASHINGTON, Jan. 22 — As it expanded aggressively overseas in the 1990's, the Enron Corporation won an exemption from a Depression-era law that would have prevented its foreign operations from shifting debt off their books and that barred executives from investing in partnerships affiliated with the company.

The exemption enabled Enron's foreign operations to engage in the kind of financial engineering that experts now say was reminiscent of some of the corporate excesses of the 1920's that led to the 1940 law and that were an important element of the company's meteoric rise and startling collapse.

Had Enron not been granted the exemption, some of its operations in South America and in Europe would not have been able to structure financial operations to both conceal them from investors and shift debt off their books.

Enron's initial efforts in 1996 to persuade Congress to change the law were thwarted by opposition from a powerful trade group and some federal regulators. The company responded by hiring the former boss of a leading staff official at the Securities and Exchange Commission to represent it in negotiations with the agency. In an unheralded five-paragraph order in March 1997, the S.E.C. official, Barry P. Barbash, gave En-

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ron's foreign operations a broad exemption from the law — the Investment Company Act of 1940.

How Enron came to get its exemption from the severe restrictions of the law clearly illustrates the ways the company lobbied Washington and the response by the regulatory system. That system was devised during the Depression to protect investors and customers of utilities from a wide range of corporate abuses that investigators think ultimately took place at Enron.

Both Congress and the S.E.C. are reviewing the exemption to the Investment Company Act and earlier exemptions that were given to the company by the agency, including a 1993 exemption from the tough restrictions imposed by the Public Utility Holding Company Act of 1935.

Experts say that the S.E.C. rulings unshackled the company from significant accounting restraints and business dealings between the Enron companies and their executives. The 1997 exemption, in particular, cleared the path for the company to both expand overseas and make greater use of the special partnerships that have caused the company so much turmoil.

"From a regulatory standpoint, this raises a flag," said Joseph V. Del Raso, a former official at the S.E.C. in the 1980's and an expert on the Investment Company Act. "It gave them carte blanche to go all over the world and set up subsidiaries and affiliated entities that would have been prohibited under the act."

Another expert on the act, Mark A. Sargent, the dean of the Villanova law school, agreed.

"The Enron structure was not a single company with stockholders engaged in operations like an ordinary corporation," he said. "It was similar to an investment company with investments in a bunch of different companies. The decision to exempt those from the kind of protections to investors is now coming home to roost."

Arthur Levitt, who was the chairman of the S.E.C. when the 1997 exemption was granted, said today that he had no recollection of it. But he said it could be a potentially significant part of the agency's role in failing to oversee Enron.

"It may be one of those cases of the nail in the shoe of the horse," he said. "It may be one of those things that seemed insignificant at the time but can wind up being determinative."

Mr. Barbash, the lawyer at the S.E.C. who approved the exemption, said in an interview this week that he viewed the exemption as narrow because it applied only to the foreign operations of Enron and some of its subsidiaries. He said that it was successful in that it managed to head off Enron's efforts to have a broadly worded exemption written into the law "that companies could have then driven trucks through."

"Enron knew the regulatory boxes, and they tried to fashion their businesses to fall outside of those boxes," Mr. Barbash said. "Much of what's been written so far about the company is that it turned itself inside out like a pretzel to fall outside of restrictions — accounting restrictions, taxpayer restrictions and regulatory restrictions."

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Another former S.E.C. official who is an authority on the Investment Company Act, was more critical.

"This was a case of giving Enron an inch and they took miles," said the former official, who spoke on the condition of anonymity. "They were given a significant new opportunity, and they took it and flew it smasho into the ground."

Mark Palmer, an Enron spokesman, did not return a call seeking comment.

Mr. Barbash, who at the time was director of the investment management division at the S.E.C., said that Enron's lawyers came to him in 1996 after the company had failed to persuade Congress to grant the company broad exemption to the 1940 law.

Enron and several of its subsidiaries said they needed the exemption because their foreign operations were quickly taking on the characteristics of investment companies. The act, which regulates mutual funds and other kinds of investment companies, generally applies to companies that hold at least 40 percent of their assets in securities that are passive investments and not controlling interests.

A lawyer who represented Enron said that although the company and its foreign subsidiaries had actually controlled many of their overseas ventures, like power plants, they were unable to have a 51 percent stake in them because of local rules and political constraints.

In 1996, Congress rewrote parts of the act but refused to grant an exemption to Enron because of significant opposition from both the S.E.C. and the Investment Company Institute, the main trade organization for the mutual fund industry and a strong supporter of the law. Mr. Barbash said that in 1996, Congressional aides advised Enron's lawyers to seek an exemption directly from the agency.

The company decided to retain Joel H. Goldberg, a former director of the investment management division at the S.E.C., who said today that he did not know how the company came to hire him.

An Enron official said the company had retained Mr. Goldberg knowing that he had previously been Mr. Barbash's boss and was his predecessor at the S.E.C. Mr. Goldberg had been Mr. Barbash's supervisor at the S.E.C. in the 1980's and the Labor Department in the 1970's. The two lawyers are now partners at the international law firm of Shearman & Sterling.

Mr. Goldberg said he viewed the exemption as a narrowly tailored one intended to permit the company to continue its overseas projects. But he acknowledged that had the company not been granted the exemption, it would have been constrained from using any partnerships or shifting debt off the books in its foreign operations.

"I guess on the one hand, if they had been subject to the Investment Company Act, they probably could not have done these transactions," he said. "The subsidiaries would not have existed, and they would have had to make another plan."